

Are all your customers profitable?

Fiona Flynn, Director of Sales and Marketing, StaffBalance™, looks at how company executives are taking a more sophisticated look at customer profitability and in particular cost-to-serve as a driver for business growth. She explains how, using simulation modelling software, you can gain a clearer understanding of the profitability of your customers, people, products and channels.

It came as an enormous surprise to a sales director of a major corporate company, when he discovered that his biggest clients were losing the company money. All that time spent negotiating deals with these particular clients to keep them on side - delivering the goods to tight deadlines, providing service above and beyond, building relationships with key decision-makers - all yielded a high revenue but not a profitable revenue.



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For all of us engaged in selling, the crucial question is: Can you tell which of your customers are profitable and which ones actually cost you money to serve?

The traditional metrics such as revenue streams and market share are useful indicators of a company's income and market positioning but they don't give you the full picture. Net Profitability is the clearest indicator of how cost-effective it is to provide your full product and service suite to customers.

The Pareto Rule in a new light

There is a generally held view that the Pareto Principle also known as the 80:20 Rule holds true for all businesses: 80% of profit is derived from 20% of customers. However, new light is shed on customer

profitability by Dr Robert Kaplan, of the Harvard Business School and his research shows that:
The most profitable 20% of customers deliver between 150% and 300% of profits.
The middle 70% of customers are at breakeven level and the least profitable 10% of customers lose the company between 50% and 200% of total profits.

This means that often, some of your largest customers turn out to be the most unprofitable. The Whale Curve (below) is a useful graphic to illustrate how this works. The high profitability of the top tier of customers balances out

against the unprofitable lower tier of customers so that you achieve your 100% profitability figure.

There are serious implications for a company that cannot measure and manage customer profitability. These can include:

- >> Breakdown in relationships between customers and suppliers.
- >> Excessive demand by customers for free services or heavily discounted products.
- >> Over servicing of unprofitable customers, due to lack of information.

How to determine cost-to-serve

So how do businesses get a handle on that valuable cost-to-

Analysis



serve information? Special software and expert analysis is required to investigate the complex range of variables that impact the profitability of delivering to the end user. The analysis can be carried out relatively easily using simulation software technology. This technology is used to calculate the profitability of individual customer relationships.

In most large businesses, there are multiple channels, complicated product sets, legacy data systems and even a widely dispersed organisation. Simulation modelling helps to pull the complex and diverse data together to give you customer profitability information that makes sense.

The simulation software is a practical decision making tool-set for managers, which helps you to quickly identify and build profitable revenue streams, manage staff resources more effectively and understand and control the underlying cost structure and profitability of customers, products, and channels.

Once companies fully understand the profitability on a customer by customer basis, their relationships improve. This granularity of detail gives the company leverage to give discounts to profitable customers and to provide an enhanced service level. It also empowers your sales team to negotiate better terms with less profitable customers - such as bulk delivery, more favourable payment terms and charging for value added services. Pricing is made considerably more valid by the clear understanding of cost-to-serve.

In May 2001, Robert Kaplan and a team from Harvard Business School identified the behaviours of customers who tend to be highly profitable and unprofitable. These are detailed below. The team also discovered that it is impossible for a large customer to be marginally profitable. Large customers tend to be either highly profitable or very unprofitable.

HIGH COST-TO-SERVE CUSTOMERS

- >> Order custom products
- >> Small order quantities
- >> Unpredictable order arrivals
- >> Customised delivery
- >> Change delivery requirements
- >> Manual processing
- >> Large amounts of pre-sales support (marketing, technical and sales resources)
- >> Large amounts of post-sales support (installation, warranty, field service, training)
- >> Require company to hold inventory
- >> Pay slowly (high accounts receivable)

LOW COST-TO-SERVE CUSTOMERS

- >> Order standard products
- >> High order quantities
- >> Predictable order arrivals
- >> Standard delivery
- >> No changes in delivery requirements
- >> Electronic processing, zero defects
- >> Little or no pre-sales support (standard pricing and ordering)
- >> No post-sales support
- >> Replenish as produced
- >> Pay on time

How analysis of customer profitability leads to profitable customers

This simulation modelling of your business gives you the detailed data you need to make the decisions to ensure that your customers are profitable. This is done by drilling down into your data to understand which customer behaviours or internal processes are costing the company and negatively impacting the bottom line.

Profitability dash board reporting gives you information on an ongoing basis to enable you to measure efficiency improvements and negotiate the deals that ensure your customers move into the profitability zone.

Once you have the data in front of you, there are three components that you can use to improve customer profitability:

- >> Process - improving how you deliver to your customers.
- >> Pricing - appropriate price levels to ensure profitability
- >> Relationship - developing more transparent relationships with customers.

Simulation modelling gives you the tools to analyse and deeply understand which of your customers are profitable and which are unprofitable. By factoring in the real costs associated with each customer, you can make adjustments, both operational and financial, that will favourably impact on your bottom line.

About StaffBalance™

StaffBalance™ delivers an innovative cost and profitability management solution to financial services, insurance and utility companies helping them seize profit opportunities by reducing costs, balancing staff resources and maximising the profitability of customers, products, and channels: all without disrupting mission-critical systems or people.

The company delivers an innovative profitability and cost management software solution. This practical and effective decision making toolset helps companies quickly identify and build profitable revenue streams, manage staff resources more effectively and understand and control the underlying cost structure and profitability of customers, products and channels.

1* Source: Dr Robert Kaplan and V.G. Narayanan, "Measuring and Managing Customer Profitability", Journal of Cost Management Harvard Business School

The StaffBalance™ client base includes: Bord Gais, KBC, and Zurich. They have already saved their customers over €1m in costs.

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